Office Supreme Court, U.S.
FILED
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In the Supreme Court

of the United States

OCTOBER TERM 1962

No. 708

WHITE STAG MANUFACTURING COMPANY,

Petitioner-Appellant,

v.

DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon,

Defendants-Appellees.

On Appeal from the Supreme Court of the State of Oregon.

JURISDICTIONAL STATEMENT

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WHITE STAG MANUFACTURING COMPANY,

Petitioner-Appellant,

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DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon.

Defendants-Appellees.

On Appeal from the Supreme Court of the State of Oregon

JURISDICTIONAL STATEMENT

Appellant, hereinafter called plaintiff, appeals from the decree of the Supreme Court of the State of Oregon, entered on August 14, 1962, affirming the decree of the Circuit Court of the State of Oregon for the County of Multnomah entered on April 21, 1961, dismissing plaintiff's complaint, and submits this Jurisdictional Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial questions are presented.

A. CITATIONS TO OPINIONS BELOW

(1) The opinion of the Supreme Court of the State of Oregon (R. 65), review of which is sought, is printed on pages A13 to A24 of the Appendix, infra. This opinion is officially reported in 74 Or. Adv. Sh. 1229 and unofficially in 373 P.2d 999.

(2) The memorandum opinion, dated April 12, 1961, (R. 20-25), and the supplemental memorandum opinion, dated April 18, 1961 (R. 28-29), of the trial court, being the Circuit Court of the State of Oregon for the County of Multnomah, are not reported. Copies thereof are printed on pages A5 to A13 of the Appendix, infra.

(3) The opinion and order No. I-60-48, dated October 11, 1960, of the State Tax Commission of the State of Oregon, is not reported. A copy thereof is printed on pages A1 to A5 of the Appendix, infra.

B. STATEMENT OF GROUNDS ON WHICH JURISDICTION IS INVOKED

(1) This proceeding is a suit brought under Oregon Revised Statutes, section 314.460 (ORS 314.460) as an appeal by the plaintiff to the Circuit Court of the State of Oregon for the County of Multnomah from opinion and order No. I-60-48, dated October 11, 1960, of the State Tax Commission of Oregon (A1 to A5, infra), which opinion and order determined that plaintiff is liable for deficiencies in Oregon corporation excise taxes for the fiscal years ended November 30, 1956, and 1957. Ths Commission's determination was made under authority of Regulation 4.280(1)—(B) (formerly 7.180

(1)—(B)) promulgated by it, *White Stag Mfg. Co.* v. *State Tax Comm.*, 74 Or. Adv. Sh. 1229, 373 P.2d 999 (A14, infra), which regulation is a statute of the State of Oregon within the meaning of 28 U.S.C. Sec. 1257(2) as is shown by the last four cases cited in the following paragraph 4.

After a trial on said appeal, the Circuit Court of the State of Oregon for the County of Multnomah, on April 12, 1961, delivered its memorandum opinion (A5 to A11, infra; R. 20-25), and, on April 18, 1961, its supplemental memorandum opinion (A12 to A13; R. 28-29) holding that a decree should be entered dismissing plaintiff's complaint, and said court on April 21, 1961, made and entered its decree herein dismissing the complaint (R. 30).

On May 12, 1961, plaintiff filed its notice of appeal to the Supreme Court of the State of Oregon from said decree (R. 31). The appeal to the Supreme Court of the State of Oregon was taken pursuant to ORS 314.460 and ORS 19.005 et seq. Plaintiff contended that said Reg. 4.280(1)—(B) as applied by defendants to plaintiff violates Article I, § 8, Clause 3 of the U. S. Constitution, and the due process of law and equal protection of the laws clauses of the Fourteenth Amendment of the U. S. Constitution. On March 7, 1962, the Supreme Court of the State of Oregon heard arguments on appeal, and on August 14, 1962, filed its opinion (A13 to A24, infra; R. 65).

(2) The decree of the Supreme Court of the State of Oregon sought to be reviewed is dated and was en-

tered on August 14, 1962 (A24 to A26, infra; R. 66) Plaintiff filed a petition for rehearing in the Supreme Court of the State of Oregon, and on September 18, 1962, that court made and entered an order denying said petition (A26 to A27, infra; R. 67). A memorandum of said order is reported officially in 75 Or. Adv. Sh. No. 2, p. 2.

On November 7, 1962, notice of appeal to the Supreme court of the United States was filed in the Supreme Court of the State of Oregon (R. 68-71, and also in the Circuit Court of the State of Oregon for the County of Multnomah (R. 59-62). A copy of each notice was duly served on counsel for defendants.

(3) The jurisdiction of the Supreme Court of the United States to hear this appeal rests upon 28 U.S.C. Sec. 1257 (2), 28 U.S.C. Sec. 2101(c) and 28 U.S.C. Sec. 2103.

(4) The cases believed to sustain jurisdiction of this court are:

Dahnke-Walker Milling Co. v. Bondurant, 257 U. S. 282, 42 S. Ct. 106, 66 L. Ed. 239 (1921).

Miller v. Schoene, 276 U. S. 272, 48 S. Ct. 246 72 L. Ed. 568 (1927).

Fiske v. Kansas, 274 U. S. 380, 47 S. Ct. 655, 71 L. Ed. 1108 (1926).

Lathrop v. Donohue, 367 U. S. 820, 81 S. Ct. 1826, 6 L. Ed. 2d 1191 (1960).

Atchison R. Co. v. Public Utilities Comm., 346 U. S. 346, 74 S. Ct. 92, 98 L. Ed. 51 (1953).

McCollum v. Board of Education, 333 U. S. 203, 68 S. Ct. 461, 92 L. Ed. 649 (1948).

Lake Erie & W.R.R. Co. v. Public Utilities Comm., 249 U. S. 422, 39 S. Ct. 345, 62 L. Ed. 684 (1918).

(5) The validity of Regulation 4.280(1)—(B) of the State Tax Commission of Oregon, as applied to the plaintiff, is involved herein. The verbatim text of that portion of the regulation relevant to this appeal is set forth in the Appendix (A29 to A34, infra). The regulation provides for a three-factor formula for the allocation income earned within and without the State of Oregon. The factors are property, wages and sales. The provision of the regulation principally involved is as follows:

> "Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor."

The regulation is officially published in *Personal Income and Corporation Income and Excise Tax Laws and Regulations*, 1959, Issued by the Oregon State Tax Commission, Salem, Oregon, pages 10, 11 and 12.

The constitutional provisions involved are as follows:

United States Constitution, Article I, Section 8, Clause 3:

> "Section 8. The Congress shall have Power * * *
>
> * * * * *
>
> "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

Fourteenth Amendment to the United States Constitution:

> "* * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State

deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

C. QUESTIONS PRESENTED BY THE APPEAL

1) Whether Reg. 4.280(1)—(B) promulgated by the Oregon State Tax Commission as said regulation was construed and applied by the Oregon Supreme Court to the appellant is invalid on the ground of its being repugnant to Article I, Section 8, Clause 3 (the commerce clause) of the Constitution of the United States and to the privileges and immunities, equal protection and due process of Section 1 of the Fourteenth Amendment of said Constitution, or to any one or more of said constitutional provisions.

2) Whether the exclusion from the three-factor formula mentioned in paragraph B (5) above of all parts of all sums paid by the appellant to factories in and out of Oregon for manufacturing goods for appellant out of its materials and according to its orders and specifications violates said provisions of the Constitution of the United States, or any of them, or violates the right or privilege claimed by appellant under said constitutional provisions to include a portion of said sums in the wage or property factor, or both said factors, of the formula.

D. CONCISE STATEMENT OF THE CASE

During the fiscal years ended November 30, 1956 and 1957, the gross income of plaintiff, a corporation,

was derived from business done both within and without the State of Oregon. In order to fairly allocate a portion of its gross income to Oregon, plaintiff included in the "wage factor" of said three-factor formula a part of the fees paid by it to third party plants for manufacturing merchandise for it. The State Tax Commission disallowed this inclusion and asserted deficiencies in Oregon corporation excise taxes against plaintiff. In disallowing said inclusion the commission acted under its Reg. 4.280(1)—(B). Plaintiff instituted this proceeding to secure a determination that no deficiencies exist on account of including such fees in the wage factor, and to have the defendants permanently enjoined from collecting any tax based on such exclusion. Plaintiff drew in question the validity of the regulation on the ground that the same as applied to plaintiff, it is repugnant to the Constitution of the United States. The decision of the Supreme Court of Oregon was in favor of the validity of the regulation. Other constitutional questions were also timely raised by plaintiff.

Plaintiff is an Oregon corporation. During the years herein involved, plaintiff was engaged in the manufacture and sale of clothing and canvas products. It owns plants in Portland, Oregon, San Francisco, California and Amsterdam, New York. During said times, approximately 29 plants owned by third parties manufactured garments for plaintiff. Plaintiff did not buy garments from these third party plants. It furnished them with all the materials out of which garments were made, except thread. The plants provided the thread and performed the labor and were paid by plaintiff for so doing.

During the fiscal years ended November 30, 1956 and 1957, the years herein involved, nine or ten of the third party plants manufactured exclusively for plaintiff. The others manufactured for plaintiff on a non-exclusive basis. Plaintiff kept a supervisory production engineer in two of the plants. Other men from plaintiff visited the other third party plants where they performed supervisory services for plaintiff.

Plaintiff's supervisory personnel did not manage the employees of these plants, or hire or fire them; and plaintiff did not technically lease or rent the third party plants from the owners.

Plaintiff set up a production program with each third party plant on the basis of its weekly production capacity and promised to keep the plants busy.

The prices, which plaintiff could pay the third party plants, were calculated by plaintiff in Portland. In pricing, the cost of production was figured by plaintiff on the basis of the cost at the particular plant that was to do the manufacturing. Agreements were made with each third party plant with respect to the price plaintiff was to pay for each garment made by the plant. The prices which were to be paid were negotiated on the basis of the labor involved, but were subject to correction if the third party made a mistake in his calculations.

The prices agreed upon were confirmed by plaintiff by letter. Thereafter the fabrics were ordered into the plants, cutting orders were issued to them, and the garments were manufactured for plaintiff pursuant to

said orders and in accordance with patterns and specifications furnished by plaintiff to the plants. The cutting orders were usually placed weekly, as plaintiff tried to keep the third party plants busy each week at capacity.

Plaintiff exercised a great deal more control over the third party plants than would ordinarily be the case if it had been merely buying garments.

During the years involved, plaintiff sold its merchandise throughout the world. The goods manufactured for plaintiff by the third parties were held and shipped by them in accordance with plaintiff's instructions.

During the years in question, plaintiff did not have any third party plant under contract; and, except for the cutting orders, did not give any third party plant a contract to produce any portion of its garment requirements. Plaintiff took no performance bond from any plant and no plant was subject to any penalty if it failed to perform on time. On a number of occasions, plaintiff made adjustments when it learned that a third party manufacturer was losing money on the prices he was receiving. In the garment business when there is an actual contract with a plant to produce at a certain price, no adjustment is made in the absence of an adjustment provision, and such contracts normally have an adjustment provision, penalty clauses and provide for bonds.

During the fiscal year ended in 1956 and for a part of the fiscal year ended in 1957, ORS 317.180 was in effect. A copy of this statute is printed in the Appendix.

A28, infra. ORS 317.180 was replaced by ORS 314.280 which, as far as relevant in this proceeding, is identical to ORS 317.180. A copy of ORS 314.280 is printed in the Appendix, A27, infra.

Pursuant to ORS 314.280 and to ORS 314.815 the State Tax Commission in Regulation 4.280(1)—(B) (formerly Reg. 7.180(1)—(B) promulgated said three-factor formula (A31, infra) for the allocation of income derived from business done both within and without the State of Oregon. Reg. 4.280(1)—(B) (A33, infra) is in part as follows:

> **"Wage factor.** The wage factor is the percentage that the total wages, salaries and other compensation for personal services paid during the taxable year to employes in connection with the business carried on within this state bears to such payments to employes during the taxable year in connection with the business carried on both within and without this state.
>
> "Wages, salaries and other compensation must be included in the Oregon factor to the extent that services for which the compensation is paid were within the state. Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor."

For the fiscal year ended November 30, 1956, plaintiff's net income was $1,181,860.07. During said year, plaintiff paid $2,292,805.98 for direct labor, and $3,221,744.65 to third party plants for manufacturing garments for plaintiff out of plaintiff's materials. Most of the latter amount was paid to third party plants located out of Oregon. Due to the fact that a large percentage of plaintiff's manufacturing was carried on

outside of Oregon by the third party plants, and to the additional fact that the manufacturing operation is largely labor, the three-factor formula was weighed heavily against plaintiff and would have resulted in allocating income to Oregon that was not earned in Oregon, unless a reasonable portion of the fees paid to the third party plants were included in the formula.

In order to accomplish a fair and equitable allocation to Oregon of a portion of plaintiff's income for said year, plaintiff on its State of Oregon corporation excise tax return increased the wage factor by 70 per cent of the prices paid by plaintiff to the third party plants. Said percentage of the $3,211,744.65 is $2,255,221.26 of which the sum of $51,865.34 was paid to third party plants operating in Oregon, and the balance to plants operating outside of Oregon. With this amount included in the wage factor, the formula allocated 29.8919 per cent or $388,150.45 of plaintiff's net income to Oregon and the same was reported on said return as plaintiff's Oregon net income for said year. The inclusion and the reason therefore and reasonableness thereof was explained on the return (Ex. 14).

Plaintiff's net income for the fiscal year ended November 30, 1957 was $674,433.63, and its expenditure for direct labor was $2,292,655.20 and for third party manufacturing was $2,055,794.18. For the same reason as above stated, 70% of the fees paid the third parties during this year was included in the wage factor, and with this inclusion, the formula allocated to Oregon 35.7357 per cent or $249,475.60 of plaintiff's net income

for the year, and plaintiff reported its Oregon net income for the year in that amount.

Although the figure of 70% was used by plaintiff in calculating the portion of the sums paid the third parties that actually represented labor in manufacturing, the percentages as subsequently calculated are 73.23 per cent and 70.49 per cent respectively for the years involved, thus the 70 per cent used was favorable to the state. Figures from the records of one of the plants manufacturing exclusively for plaintiff show that 73.3 and 76.2 per cent of the fees were paid out as wages.

Defendants mailed plaintiff a notice of proposed deficiency (Ex. 13) for said years in which they excluded from the allocation formula the fees paid the third party plants that plaintiff had included therein as aforesaid. The effect of the defendant's action was to remove only 2.8 and 3.8 per cent of wages from the Oregon side of the wage factor for said years respectively, and 49.6 and 38.6 per cent from the everywhere side. In this manner, defendants increased the percentage and amount of plaintiff's net income apportionable to Oregon for those years as follows:

Reported by Plaintiff

FY 1956	29.8919% or $388,150.45
FY 1957	35.7375% or $249,475.60

Increased by Defendants to

FY 1956	42.33 .3% or $530,536.76
FY 1957	45.3703% or $335,993.35.

The Portland office of the accountant firm of Peat, Marwich, Mitchell & Company computed the Oregon

income of the plaintiff for the years in question by a method equivalent of direct accounting. This showed that plaintiff's Oregon net income for the years in question was $399,483.14 and $228,052.87 respectively, or that plaintiff's Oregon net income for fiscal year 1956 was only about $11,000 or 2.8% higher and for the fiscal year 1957 about $21,000 or 9.4% less than plaintiff reported by the allocation method as employed by it; whereas the defendants assert, in effect, that plaintiff's Oregon net income for those years was about $130,000 and $108,000 higher, respectively, than said direct segregated accounting shows that it was, and about $142,000 and $86,500 higher, respectively, than plaintiff reported by the allocation method as employed by it.

By the disallowance of the third party fees in the wage factor, defendants increased plaintiff's net income attributable to Oregon as follows:

Fiscal year	In excess of amount actually earned in Oregon per direct accounting	In excess of amount reported per allocation
1956	32.8%	36.7%
1957	47.3%	34.7%

In disallowing the inclusion in the wage factor of the fees paid the third parties, the defendants relied on their Reg. 4.280(1)—(B), and the Supreme Court of the State of Oregon sustained them in so doing. This increased plaintiff's tax liability for the years in question by a sum exceeding $9,000 including interest.

Pursuant to ORS 314.460, this case was instituted in the Circuit Court of the State of Oregon for the

County of Multnomah as an appeal from opinion and order No. 1-60-48 of the Oregon State Tax Commission (A1-A5, infra), which determined that plaintiff was liable for deficiencies in Oregon corporation excise taxes for the years herein involved. As far as this appeal was concerned, the determination was based on income allocated to Oregon by the Tax Commission by use of the three-factor formula after all fees paid the third party plants had been excluded by the Tax Commission. A trial was had. Thereafter, the Circuit Court delivered its opinion and supplemental opinion (A5-A13, infra; R. 20-29) and then entered a decree dismissing plaintiff's complaint (R. 30). Pursuant to ORS 314.460 and ORS 19.005 et seq., plaintiff appealed from this decree to the Supreme Court of Oregon. The appeal was argued. Thereafter, the Supreme Court delivered its opinion (A13-A24, infra; R. 65) and entered a decree affirming the decree of the Trial Court (A24, infra; R. 66). Plaintiff petitioned for a rehearing, which was denied (A26, infra; R. 67).

How the Federal Questions Are Presented

The constitutional questions sought to be reviewed by the Supreme Court of the United States were raised as set forth in this paragraph. In the complaint filed in the Trial Court, plaintiff, in effect, alleged that the determination of the State Tax Commission that no part of the fees paid by plaintiff to third parties is wages (In the second cause of suit in lieu of "wages", the words "wages and rental payments" are alleged.) for the purpose of allocating its net income to Oregon

violated the equal protection of the laws and due process clauses of the Fourteenth Amendment of the Constitution of the United States, and also violated Article I, Section 8, clause 3, the commerce clause, of that constitution. (R. 1-11). In the brief filed by plaintiff in the Supreme Court, plaintiff assigned as error that the decree of the Trial Court violates said constitutional provisions and denies plaintiff the relief it is entitled to thereunder (Appellant's Abstract of Record and Brief, pp. 31-32, Certified copy filed in Supreme Court of the United States). Points and Authorities III, IIIA, IV and VIII, pages 32-35 of said brief state that if the use of a formula taxes income not earned in the taxing jurisdiction it violates the Federal constitution and that Regulations 7.180(1)—(B) and 4.280(1)—(B), as applied by defendants in this case violate said constitutional provisions for reasons therein stated, which are substantially the same as those hereinafter set forth.

In its opinion, the Trial Court held, in effect, that if the formula becomes unreasonable in a particular case to the extent that plaintiff is being taxed on an amount not earned in Oregon, it is unconstitutional and that plaintiff failed to prove that such is true. (A10, infra; R. 24).

The Supreme Court of Oregon in its opinion held

> "Plaintiff asserts that Regulation 4.280(1)—(B), supra, when applied by the Commission as it has done, is unconstitutional, both under the Fourteenth Amendment of the Federal Constitution and Art. I, § 32, of the Oregon Constitution, in that they impose substantially higher corporate excise taxes on plaintiff than are imposed by the laws of

> Oregon on other corporations earning the same net income in Oregon as plaintiff earned and its formula has allocated to Oregon income not earned by plaintiff in Oregon and thereby subjected plaintiff to taxation that is not uniform on the same class of subjects. We find no merit in this representation. The constitutional questions raised have several times before had the attention of this court and federal courts and where they have been resolved against plaintiff's contention. * * * (R. 65; A23, infra)

The foregoing are the only mention by either court of said unconstitutional questions. The affirmance by the Oregon Supreme Court of the trial Court's decree is the equivalent to an express holding in favor of the validity of the Regulation against the contention that it is repugnant to all said constitutional provisions invoked in the complaint and brief as well as against the contentions specifically mentioned by the court. *Dahnke-Walker Co.* v. *Bondurant*, 257 U.S. 282, 289, 42 S. Ct. 106, 66 L. Ed. 239 (1921).

E. SUBSTANTIAL FEDERAL QUESTIONS ARE INVOLVED.

As far as plaintiff has been able to discover there is no reported case with a factual situation comparable to the instant case, and in no case, except this one, has any court considered the questions presented by this appeal. The questions, however, are substantial and important. The grounds upon which it is contended that the questions are substantial and the reasons why the questions are so substantial as to require plenary consideration, briefs on the merits and oral arguments are hereinafter set forth.

Reg. 4.280(1)—(B) provides for a three-factor formula consisting of property, wages and sales, and it provides that payments made to bona fide independent contractors are not included in the wage factor. During the fiscal years November 30, 1956 and 1957, plaintiff paid fees to third-party plants for manufacturing merchandise for plaintiff out of its materials and according to its specifications. Plaintiff included a fair portion of these fees in the wage factor of the formula. Acting under Reg. 4.280(1)—(B) the inclusion of that portion of those fees was disallowed with the result that, as applied to the plaintiff, the regulation allocated to Oregon for the fiscal years mentioned about 32.8% and 47.3% more net income than plaintiff earned in Oregon during said years, and, consequently, subjected to substantially higher excise taxes than would be taxed to a corporation earning the same net income in Oregon as plaintiff earned, but which had paid no such third party fees.

Many states include wages and or property in formulas for allocating to the state a portion of the income derived from business done within and without the state, and thousands, perhaps tens of thousands of taxpayers must annually employ these formulas in reporting their income for tax purposes. Each year they must resort to formulas that may or may not indicate whether sums paid to contractors or any part thereof may be included in the formula, and there has been no final determination that such sums may be excluded without violating the due process and equal protection clauses of the Fourteenth Amendment; and in cases

involving interstate commerce, without violating Article I, Section 8, clause 3 of the United States Constitution.

A determination of these questions is sought in this proceeding, and it is vital that they be answered by this court. To allow the decision of the court below to stand would put many taxpayers at a substantial disadvantage with their competitors as indicated by the following example. The Oregon corporation excise tax is 6 per cent of net income. Under the decision of the Oregon Supreme Court, two Oregon corporations engaged in the business of manufacturing and selling goods within and without the state and having equal net income would pay materially different amounts as excise taxes in case one did its out of state manufacturing in its own plants and the other had goods manufactured out of its own materials, according to its own designs and specifications and under its supervision in plants owned and operated by third parties. In the one case the out of state plant values and wages would be allowed in the wage and property factors of the three-factor formula and in the other case no part of the fees paid the third-party plants would be permitted in the formula, with the result that, depending upon the volume of out of state wages and plant values, one taxpayer would be required to pay much greater taxes than the other.

It is no answer to this inequality to suggest as did the Oregon Court (A20) that the taxpayer paying the third-party fees may deduct the same from its gross income in determining its net income. That is deducted in any event just as the wages, property taxes and in-

surance are deducted by the other taxpayer. It is the amounts that go into or that are excluded from the formula that bring about the inequality.

Nor is it a satisfactory answer to say that a state may classify corporations for the purpose of taxation. In the first place the state has not attempted to put manufacturing concerns owning and operating out of state plants into one class and to put those that do not into another class; and, if it had, the classification would be as unreasonable and as arbitrary as that condemned in *Royster Guano Co.* v. *Virginia*, 253 U.S. 412, 40 S. Ct. 560, 64 L. Ed. 989 (1919).

There is no economic difference between paying labor directly and paying it as part of the fees paid to third-party plants for manufacturing out of the taxpayer's materials according to his specifications. In each case the payment is for converting the taxpayers materials into his finished products and in each case the labor cost is an expense of doing business. In each case the labor would be performed in the same locality. It cannot be fairly said that the one mode of operation is less of a business activity than the other.

The first question stated on page 6 hereof presents two issues: 1) whether Reg. 4.280(1)—(B) (A28 to A34, infra), in its entirety, as applied to plaintiff, is unconstitutional; and 2) whether, aside from the constitutionality of the rest of the regulation, the provision thereof that, "Payments made to bona fide independent contractors employed by plaintiff are not included in the wage factor", as applied to the plaintiff, is unconstitutional.

It is vital concern, not only to plaintiff, but to all taxpayers who employ third-party plants, that this court settle the question of whether a state may constitutionally prohibit a taxpayer from including in a three-factor formula any part of the fees he pays third-party plants for manufacturing goods for him out of his materials according to his specifications.

When a corporation's gross income is derived from business done within and without Oregon, its Oregon corporation excise tax must be measured only on the net income earned by it on business done within the state. ORS 317.180, ORS 314.280, *Hines Lumber Co. v. Galloway*, 175 Or 524, 531-537, 154 P.2d 539 (1944).

Because Reg. 4.280(1)—(B), as applied to plaintiff, subjected it Oregon corporation excise taxes substantially in excess of the amounts it would be required to pay if the taxes were measured on plaintiff's Oregon income, it contends that the regulation is repugnant to the due process and equal protection clauses of the Fourteenth Amendment of the United States Constitution. In principal the situation is much the same as that in *Royster Guano Co. v. Virginia*, 253 U.S. 412, 40 S. Ct. 560, 64 L. Ed. 989 (1919), wherein the plaintiff, a Virginia corporation, engaged in business within and without the state, and had net profits from its within state and also from its out of state bbusiness. A state statute imposed an income tax of one per cent upon all earnings of business done in or out of the state. Another statute exempted from taxation, domestic corporations which did no business in the state. Virginia taxed the plaintiff on its state and out of state

income. This Court held that there was an arbitrary discrimination amounting to a denial of equal protection of the laws within the meaning of the Fourteenth Amendment.

On the facts, the case of *McCarroll* v. *Gregory-Robinson-Speas, Inc.*, 198 Ark. 235, 129 S.W. 2d 254 (1939), are similar to those of the *Roystér Guano Co.* case. In the *Gregory* case the State Supreme Court held that the two Arkansas acts taken together imposed upon the appellee a discriminatory and arbitrary exaction of the tax and to that extent, the one so doing was unconstitutional, being violative of appellee's rights under the Fourteenth Amendment. The court said:

> "* * * the imposition of an income tax upon a domestic corporation, doing business both within and without this state, on income derived from sources outside of Arkansas denies to such domestic corporation the equal protection of the laws and amounts to the taking of property without due process in violation of the Fourteenth Amendment * * *" (258)

To the same effect please see *Cheney* v. *Stephens, Inc.*, — Ark —, 330 S.W. 2d 949 (1960).

Reg. 4.280(1)—(B) also imposes a higher tax on plaintiff than it would impose on an Oregon corporation having the same Oregon income, but doing no out of state business. For this added reason the above mentioned clauses of the Fourteenth Amendment are violated.

Much of the merchandise from the sale of which the plaintiff's income from years involved arose was manufactured at plaintiff's direction out of plaintiff's

materials according to plaintiff's specifications in third party plants located out of Oregon, and was delivered to plaintiff's customers in the course of interstate commerce. The inclusion in the measure of the tax of the part of plaintiff's net income which was not earned by plaintiff in Oregon was a burden on interstate commerce in violation of Article I, section 8, clause 3 of the United States Constitution. If plaintiff's net income had been fairly apportioned, this constitutional provision would not have been violated. The violation arises out of the fact that income not earned in Oregon was included to measure an Oregon excise tax. The income could not be lawfully included in the measure of the tax for two reasons: 1) Its inclusion violated the Fourteenth Amendment as indicated above, and 2) also violated the law of Oregon. ORS 317.180, ORS 314.280; *Hines Lumber Co. v. Galloway, supra*. This distinguishes the case for those permitting a state in certain instances to impose a tax against a domestic corporation on net income derived from interstate commerce.

Reg. 4.280(1)—(B), as applied to plaintiff, violated the last mentioned provision of the United States Constitution in that it burdened interstate commerce by requiring out of state income to be included in the measure of the tax, and in particular by providing that the fees paid the third parties could not be included in the formula thereby allocating to Oregon income not earned in Oregon. This inclusion subjects plaintiff to higher excise taxes than could properly be based on its Oregon income—the only lawful basis for the tax—and thus, interstate commerce is made to bear the burden of the taxes.

An allocation formula is invalid if it attributes to the taxing state an unreasonable portion of the taxpayer's unitary income. *Hans Rees' Sons, Inc. v. State of North Carolina*, 283 U.S. 123, 135, 51 S. Ct. 385 (1931). The next to the last paragraph of the opinion in the *Rees' Sons* case may be appropriately quoted in part and paraphrased in part as follows:

> "For the present purpose, in determining the validity of the statutory method as applied to the appellant, it is not necessary to review the evidence in detail, or to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in" Oregon. "It is sufficient to say that, in any aspect of the evidence," the three-factor formula, "as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to" Oregon "a percentage of income out of all appropriate proportion to the business transacted by the appellant in that state. In this view, the taxes as laid were beyond the state's authority. * * *".

There was only a one-factor formula in the *Rees' Sons* case, but the important point in this case is that it condemns the allocation to a state of income out of all proportion to the business transacted in the state. It is respectfully submitted that the allocation of 32.8 to 47.3 per cent more income to Oregon than was earned in Oregon is out of all appropriate proportion to the business done in the state.

The Oregon statute does not require the use of the three-factor formula. On the contrary, it contemplates apportionment only under rules and regulations that "fairly and accurately * * * reflect the net income of

the business done within the state." ORS 317.180 and 314.280. On several occasions the State Tax Commission has either required or permitted modifications of the formula.

To the best of plaintiff's knowledge, Reg. 4.280(1)—(B) was not in effect during the years in question. Consequently, plaintiff states that it was not then in effect. Therefore, the questions presented should be determined as if the sentence with respect to payments to independent contractors were not in the regulation. If, without this sentence, the regulation does not necessarily imply that no part of the third party fees are includible in the three-factor formula, then the exclusion thereof was the arbitrary, unreasonable, erroneous and unlawful act of the defendants—an act that is unconstitutional and invalid for exactly the same reasons (above mentioned) that makes the regulation invalid if by its terms it prohibits the exclusion of any part of those fees in the formula. See *Hines Lumber Co. v. Galloway*, supra, and *Hans Rees' Sons, Inc. v. State of North Carolina, supra*.

Not only is Reg. 4.280(1)—(B) unconstitutional for the reasons above stated, but the acts and determination of defendants in excluding from the three-factor formula any part of the fees paid the third party plants and in taxing the plaintiff on income not earned in Oregon, and the opinion and order of the State Tax Commission determining the deficiencies, and the decrees of the courts below which, in effect, sustained and upheld such acts and determinations violate each of the constitutional provisions above mentioned for the same

reasons above stated that they make the regulation unconstitutional and for the further reason that said acts determinations, opinion and order and decrees denied to plaintiff the relief, rights and immunities it was and is entitled to under said constitutional provisions namely the right not to be taxed as it was, and immunity and relief from said unconstitutional taxation which are guaranteed to plaintiff by the privileges and immunities clause of the Fourteenth Amendment of the United States Constitution. Reg. 4.280(1)—(B) is a law made by the State of Oregon—a state statute—within the meaning of USC 1257(2): *Lathrop* v. *Donohue, supra*; *Atchison R. Co.* v. *Public Utilities Comm., supra*; *McCollum* v. *Board of Education, supra*; and *Lake Erie & W. R. R. Co.* v. *Public Utilities Comm., supra*. This law has been enforced by the Oregon courts, and as enforced, this law has denied the relief and abridged those rights and immunities of plaintiff by imposing substantially higher taxes on plaintiff than it should be required to pay, and by refusing it any relief therefrom as hereinabove pointed out.

H. and I. APPENDIX "

Appended hereto is a copy of the Opinion and Order of the Tax Commission, the opinions of the courts, the decree appealed from, ORS 314.280, ORS 317.180 and Reg. 4.280(1)—(B) with notes indicating the wording of Reg. 7.180(1)—(B).

CONCLUSION

Appellant respectfully asks that plenary consideration with briefs on the merits and oral argument be granted in this case.

Respectfully submitted.

WALTER H. EVANS, JR.,
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Portland 4, Oregon.

RANDALL S. JONES,
GARTHE BROWN,
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623 Public Service Building,
Portland 4, Oregon.

APPENDIX

1. Opinion and Order, No. I-60-48 Dated October 11, 1960

STATE OF OREGON
STATE TAX COMMISSION

In the Matter of the Appeal of WHITE STAG MANUFACTURING CO. from the assessment of additional corporation excise taxes for the fiscal years ending 11-30-56 and 11-30-57.	OPINION AND ORDER No. I-60-48

On May 3, 1960, the Oregon State Tax Commission met in Salem, Oregon, to hear the appeal of White Stag Manufacturing Co. from the assessment of additional taxes for the fiscal years ending November 30, 1956 and November 30, 1957. Present were Mr. Garthe Brown, Mr. Preston P. Hiefield, Mr. Harold Hirsch, Mr. John Itrem, Mr. Frank Traeger and Mr. Walter Dee, representing the taxpayer; Commissioners Mack, Ellis and Hoefke; Mr. Frank Anderson of the Auditing Department and Mr. Gerald F. Bartz of the Law Section of the Oregon State Tax Commission.

FACTS

Petitioner was, during its fiscal years ending November 30, 1956, and November 30, 1957, and now is, engaged in the business of manufacturing sportswear and other clothing and canvas products and distributing such products all over the world. Incident thereto,

petitioner owns and operates plants and maintains offices both within and without the State of Oregon. Further, petitioner purchases raw materials and contracts for the manufacture of its products in manufacturing plants located within and without the State of Oregon which manufacture articles of clothing for petitioner in accordance with petitioner's specifications and standards. The petitioner contracts with these independent manufacturers at a rate which guarantees the manufacturer a percentage profit, and in some instances the contracts with the petitioner are sufficiently large so that the particular manufacturing plant may produce clothing almost exclusively for the petitioner. The petitioner contends that it is entitled to consider, as part of the wage factor and property factor in the allocation of income to Oregon for such years, sums paid by petitioner for contract work performed by others both within and without Oregon. Petitioner further claims that by allowing them to use a formula which includes the wage costs and property values of independent contractors who operate for them practically exclusively that a fair share of their income is allocated to Oregon.

Petitioner further contends that net income from business both within and without Oregon for said fiscal years ended November 30, 1956, and November 30, 1957, should not be reduced, in determining petitioner's net income subject to apportionment, by the amount of Oregon personal property taxes accrued but not paid by petitioner during said years. The Auditing Department in assessing the corporation additional taxes for

the years in question, which assessment was upheld by the Director of the Income Division, concluded that costs paid to others for the manufacture of products exclusively for petitioner are not includable in the wage factor and the property factor or either of them in computing the amount of petitioner's income for said fiscal years which is properly allocable to Oregon. Secondly, the Auditing Department contends that the Oregon personal property taxes deductible from petitioner's net income in determining petitioner's net income subject to apportionment is not limited to the amount of Oregon personal property taxes for which an offset was allowed petitioner for said years in accordance with Reg. 4.280(1)(a), but includes all accrued personal property taxes since the taxpayer is on an accrual basis accounting system.

OPINION

The Commission is convinced that the use of the three-factor formula of wages, property and sales is a reasonable method by which to determine the fair share of income of unitary business to be apportioned to this state. As the Commission pointed out in OF 1169, 5-19-55, payments made to independent contractors employed by a corporation are not includable in the wage factor of the allocation formula since the payments arise as a result of activities of the contractor rather than of the corporation. In addition, the difficulty of ascertaining the exact amounts to be included in the factor where there are independent concerns outside the State of Oregon to be considered is administratively unfeasible.

As to the question of the deductibility of accrued personal property taxes, the Commission is of the opinion that ORS 314.280 and Reg. 4.280 are sufficiently unambiguous in requiring that an accrual basis taxpayer eliminate from the taxpayer's income the accrued property taxes in arriving at the net income subject to apportionment.

WHEREFORE, IT IS HEREBY ORDERED that the taxpayer is liable for deficiencies for its fiscal years ended November 30, 1956, and November 30, 1957, as follows:

FYE 11-30-57		
Tax deficiency	$5,348.80	
Int. to 7-15-58	106.98	
Sub total	$5,455.78	
Less payment 7-1-58	1,888.08	
Balance	$3,567.70	
Int. on $3,567.70 7-15-58 to date	$ 481.64	
Total		$ 4,049.34
FYE 11-30-56		
Tax deficiency	$5,695.45	
Interest	1,224.52	
Total		6,919.97
Combined total due		$10,969.31

Done at Salem, Oregon, this 11th day of October, 1960.

STATE TAX COMMISSION

s C. H. MACK,
Commissioner and Chairman

[SEAL] s DEAN ELLIS,
Commissioner

s F. H. W. HOEFKE,
Commissioner and Secretary

NOTE: Your attention is called to the statutory penalty of five percent of the tax and any collection charges, plus $1, which is imposed if the tax due stated herein is not paid to the State Tax Commission within sixty days.

2. Memorandum Opinion of Trial Court
Dated April 12, 1961

IN THE CIRCUIT COURT OF THE STATE OF OREGON FOR THE COUNTY OF MULTNOMAH

WHITE STAG MANUFACTURING CO., *Plaintiff*,	No. 269345
v.	
DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, member of and constituting the State Tax Commission of the State of Oregon, *Defendants*.	MEMORANDUM OPINION

This is a suit wherein the plaintiff taxpayer seeks to have set aside a deficiency assessment by the Oregon State Tax Commission against plaintiff for Oregon Excise Tax for its fiscal year ending November 30, 1956, and its fiscal year November 30, 1957.

The plaintiff is an Oregon corporation doing business both within and without the State of Oregon and is subject to excise tax by the State of Oregon upon its net taxable income earned within the State of Oregon pursuant to ORS. 314.280 and the regulations of the Oregon State Tax Commission. The Oregon State Tax Commission in making the deficiency assessment relies upon regulation 4.380 promulgated by the Commission under statutory authority. This regulation provides a formula for the determination of a corporation's net income earned in the State of Oregon for purposes of taxation. The formula determines what percentage the three factors of taxpayer's property, wages paid and sales in Oregon is of the property, wages and sales everywhere. This percentage is then applied to the total net taxable income to determine the net taxable income in the State of Oregon. This is expressed in formula form as follows:

$$\text{Net Taxable Income} \times \frac{\text{Oregon property}}{\text{Total property}} \times \frac{\text{Oregon wages}}{\text{Total wages}} \times \frac{\text{Oregon Sales}}{\text{Total Sales}}$$

EQUALS Net Taxable Income Earned in Oregon (Apportioned)

The plaintiff is engaged in the manufacture and sale of various sportswear, clothing and canvas products in the United States and throughout the world. Part of its operation consists of obtaining certain raw materials for the purpose of having this material made by other manufacturers into certain garments. A model garment is manufactured by the plaintiff corporation in Portland, Oregon. Thereafter various manufacturers associated with the corporation are conferred with, some of

them coming to Portland and it is established with these manufacturers that they shall manufacture this particular garment for the plaintiff corporation at a certain unit price in their own manufacturing plants. There are approximately twenty-nine different manufacturers throughout the United States who from time to time manufacture garments in this manner for the plaintiff corporation. Nine of these manufacturers make garments exclusively for White Stag. These manufacturers are entirely independent organizations and in no way are connected with the plaintiff corporation. There is never a binding contract or agreement with any of these manufacturers nor is there any forfeiture, bond or other penalty for failure to perform the manufacture of the garment previously discussed. After conferring with the manufacturers, the plaintiff ships certain materials to the manufacturers' plants where they are stored and thereafter pursuant to orders from the plaintiff, "garments are made in the manufacturers' plants and shipped to the plaintiff corporation and the plaintiff corporation is thereafter billed on the basis of price discussed previously." In some instances a representative of plaintiff corporation is on hand at the manufacturers' plant in an advisory capacity, but has no authority over the operation or personnel at the plant. In some instances, if the manufacturer determines that he cannot make the garment at the price discussed without sustaining a loss, the price is altered after further negotiations.

The plaintiff corporation in filing its State of Oregon Corporation Excise Tax return for the fiscal years ending

November 30, 1956, and November 30, 1957, in determining the wage factor in the formula referred to above included an estimated amount for wages paid by the above referred to manufacturers to their own employees for the actual manufacture of the plaintiff corporation's garment. They also included in the property factor a portion paid to the manufacturers contending that that estimated portion should be construed as payment of rent for property of the manufacturer. The State Tax Commission in making a delinquency assessment declined to allow the plaintiff corporation to include such items in the wage and property factors of the formula. Due to the fact that nearly all of the manufacturers were outside of the State of Oregon, the inclusion of these amounts by the plaintiff in the formula naturally results in a much lower percentage factor to be applied to the total net taxable income of the corporation. Plaintiff contends that these amounts should be included in the formula. Further, plaintiff contends that if these amounts should not be included in the formula then the formula in this particular instance is unreasonable and arbitrary in that by its application, the plaintiff is in effect being taxed for an amount greatly in excess of the net taxable income actually earned in the State of Oregon, and further, the plaintiff contends that the use of a two-factor formula of property and sales only, without the wage factor is reasonable and results in a tax on the net income actually earned within the State of Oregon.

The first question for the Court to decide is whether or not the amounts representing wages and property

paid to the manufacturers by the plaintiff should be included in the formula. The reason for the use of a formula in determining what portion of a taxpayer's net income is actually earned in the State of Oregon is that the unitary nature of some taxpayers make it impossible to determine the net income earned in Oregon by any accounting practices. This is true of the plaintiff in this case. Income generally is earned by some activity of the person or corporation earning that income. Where it is earned depends upon where that activity is carried on. In using the three factors in the formula we must distinguish the fact that they are being used as an indication of activity of the plaintiff rather than an element of cost involved in making a profit. In other words the result of the formula is to determine out of all of the activities of the plaintiff resulting in income, what percentage of that activtiy is carried on within the State of Oregon. Therefore, in rendering a decision in this case, we must first determine if the work of the manufacturer's employees and use of their buildings in making garments for the plaintiff is actually an activity of the plaintiff corporation in producing an income.

The State Tax Commission has made a regulation setting forth that payments to bona fide independent contractors cannot be included in the formula. It is not necessary to determine whether or not the manufacturers in this case are, or are not, independent contractors. It is the opinion of the Court that in fulfilling the purposes of the formula there cannot be included in any of the three factors, amounts paid by a taxpayer to other individuals or companies as was done by plain-

tiff in this case, whether they be independent contractors or not. Wages paid by the manufacturer to employees and estimated property costs of manufacturers are not an activity of the taxpayer company to be considered in determining where its income is earned. Therefore, in this case it is held that the amounts sought to be included in the formula by the plaintiff corporation which they estimate were paid to the manufacturers for the manufacturers' employees' wages and costs of property do not reflect activities of the plaintiff corporation that produce income and should not be included in the formula.

Even though the above be true if the formula in effect becomes unreasonable in this particular case to the extent that the plaintiff corporation is being taxed on the basis of an amount of income in excess of the income actually earned in Oregon, then the formula is unconstitutional and cannot be used. The burden of proving the unreasonableness of a formula in any particular case is upon the taxpayer. It is the burden of the taxpayer to prove by clear and convincing evidence that the use of the formula is unreasonable in that it actually causes a tax to be levied against an amount of income that is in excess of the income actually earned within the State of Oregon.

It is the opinion of the Court that the plaintiff in this case has failed to prove by clear and convincing evidence that such is true. There was an attempt made by the testimony of qualified Certified Public Accountants to show the actual amount of income earned in the

State of Oregon. However, the opinions and testimony of these qualified experts was based wholly upon estimates of cost factors both within the State of Oregon and without the State of Oregon, involved in the production of income within the State of Oregon and without the State of Oregon, and in the opinion of this Court such evidence was too speculative and therefore did not meet the standard required of being clear and convincing evidence that the formula in the application to this plaintiff for the years in question was unreasonable.

The failure on the part of the plaintiff to prove that the formula in its application herein is unreasonable prevents the Court from considering the use of a two factor formula. The use of a three factor formula has been approved many times by various Courts and is more accurate and preferable to a one or two factor formula, and to revert to a two factor formula should not be considered unless the Court is convinced that the use of the formula applied has been unreasonable in taxing the taxpayer on a greater income than was actually earned within the state.

Therefore, it is the opinion of the Court that a decree should be entered dismissing the plaintiff's complaint herein and allowing the defendants their costs and disbursements incurred herein.

DATED: This 12th day of April, 1961.

WINSTON L. BRADSHAW,
Judge.

3. Supplemental Memorandum of Trial Court Dated April 18, 1961

IN THE CIRCUIT COURT OF THE STATE OF OREGON FOR THE COUNTY OF MULTNOMAH

WHITE STAG MANUFACTURING COMPANY,
Plaintiff,
v.
DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon,
Defendants.

No. 269345

SUPPLEMENTAL MEMORANDUM OPINION

Counsel for plaintiff has taken issue with two statements of fact contained in the original memorandum opinion. They are as follows:

1. Page 2. ". . . garments are made in the manufacturers' plants and shipped to the plaintiff corporation and the plaintiff corporation is thereafter billed on the basis of price discussed previously."
2. Pages 3-4 ". . . The reason for the use of a formula in determining what portion of a taxpayer's net income is actually earned in the State of Oregon is that the unitary nature of some taxpayers make it impossible to determine the net income earned in Oregon by any accounting practices."

It is the opinion of the Court that whether or not the garments made in manufacturers' plants are shipped to the plaintiff corporation at Portland or directly to

purchasers out of state, or directly to customers within the state is not material to the issues in this case. The payment of wages by the manufacturers and the use of their property is not an activity of the plaintiff.

The second statement of fact to which the plaintiff takes issue may not have been accurately stated. It was merely the intention of the Court to recite the general reason for the State Tax Commission's use of the formula and perhaps the sentence should be amended by inserting after the word "impossible" the words "for the State Tax Commission".

Otherwise, the original opinion and decision as set forth in the Memorandum Opinion shall stand as rendered and the defendant shall be entitled to a decree thereunder.

DATED: This 18th day of April, 1961.

WINSTON L. BRADSHAW,
Judge.

4. Opinion of Supreme Court of Oregon, No. 7144 August 14, 1962

IN THE SUPREME COURT OF THE STATE OF OREGON

IN BANC

WHITE STAG MANUFACTURING COMPANY,
Appellant, v. STATE TAX COMMISSION,
Respondent.

Appeal from Circuit Court, Multnomah County.
WINSTON L. BRADSHAW, Judge.
Argued and submitted March 7, 1962.

Randall S. Jones, Portland, argued the cause for appellant. With him on the brief were Jones & Brown, Portland.

Gerald F. Bartz, Assistant Attorney General, Salem, argued the cause for respondents. With him on the brief were Robert Y. Thornton, Attorney General, and Alfred B. Thomas, Assistant Attorney General, Salem.

Before McALLISTER, Chief Justice, and ROSSMAN, WARNER, PERRY, SLOAN, O'CONNELL and GOODWIN, Justices.

AFFIRMED.

WARNER, J.

The plaintiff, White Stag Manufacturing Company, seeks to set aside a deficiency assessment made by the defendant Oregon Tax Commission for plaintiff's excise taxes for its fiscal years 1956 and 1957. From a decree dismissing plaintiff's complaint, it appeals.

The Commission's determination is made under the authority of ORS 314.280 and its allocation formula established by its Regulation 4.280(1)—(B) (formerly Regulation 7.180(1)—(B)), promulgated pursuant to that statute.

Plaintiff is an Oregon corporation engaged in the manufacture and sale of sportswear and canvas products, with its principal office in Portland. It owns plants in Portland, San Francisco and Amsterdam, New York, and is conducted as a unitary enterprise both without and within the State of Oregon.

Plaintiff supplemented the output of its three owned

plants from time to time by contracting for the production of some items of its merchandise by third parties (hereinafter called "contractors") under arrangements whereby plaintiff furnishes the designs and all the material, except thread. The contractors supply the thread, labor and plants.

During the tax years 1956 and 1957 plaintiff utilized approximately 27 or 29 of these contractors, located in various parts of the United States, in the manufacture of some of its mercantile items. They are entirely independent organizations in no way connected with plaintiff except to fill its merchandise orders from time to time. Nine to 10 of this number manufactured exclusively for plaintiff. The prices paid to the contractors were the result of negotiations with each of them.

White Stag being a corporation deriving its income from business done within and without the State of Oregon, the determination of its net income allocable to this state for tax purposes is made in accordance with rules and regulations of the defendant State Tax Commission, as authorized by ORS 314.280.

The Commission applied its Regulation 4:280(1)—(B), supra, to the returns of plaintiff covering its operations for the tax years in question. Under this formula (sometimes called the Massachusetts three-factor formula), the net taxable income apportioned to Oregon is determined by giving equal weight to three factors, i.e., the corporation's property, wages and sales. This is accomplished by finding what per cent each Oregon factor of that kind bears to the corresponding total factor of

the same kind and then adding the percentages derived for the Oregon factors and dividing the result by three. The resulting percentage represents that part of the corporation's net income allocable to and taxed in this state after deducting taxpayer's payments for tax on personal property in Oregon. It can also be expressed in the following form:

$$\text{Apportionable Net Income} \times \frac{\frac{\text{Ore. Property}}{\text{Total Property}} + \frac{\text{Ore. Wages}}{\text{Total Wages}} + \frac{\text{Ore. Sales}}{\text{Total Sales}}}{3} = \text{Apportioned Net Income}$$

In the application of the foregoing formula for the years 1956 and 1957, the parties are in accord as to the proper figures employed by the state as to the sales factor, both for Oregon and everywhere. The point of difference, and, indeed, the only real issue presented on this appeal, arises from the employment by the plaintiff of different figures in the wage factor and property factor than those used by the Commission.

Inasmuch as the basic method for reckoning the wage and property factors, as made by plaintiff, is the same for both tax years, we use the figures of plaintiff in its return for the year 1957 and the figures of the Commission for each corresponding item for the same year to graphically indicate the conflict arising in their respective computations.

The percentage of net income allocable to Oregon in 1957 as computed by plaintiff is:

Factor	Oregon Totals	Total Everywhere	Percent Oregon
1—Property	$2,949,702.05	$ 7,230,743.25	40.7928
2—Wages	1,905,662.10	3,731,711.13	51.0667

3—Sales	1,033,762.48	14,009,148.77	7.3792
Total Percentages			99.2387
Oregon or Average Percentage			33.0796

The per centum of the Company's net income allocable to this state in 1957 is figured by the Commission as follows:

Factor	Oregon Totals	Total Everywhere	Percent Oregon
1—Property	$2,917,361.90	$ 5,982,288.83	48.7667
2—Wages	1,833,319.85	2,292,655.20	79.9649
3—Sales	1,033,762.48	14,009,148.77	7.3792
Total Percentages			136.1108
Oregon or Average Percentage			45.370

The fundamental difference between the foregoing calculations of plaintiff and the Commission is found in the figures used by the respective parties as plaintiff's "Everywhere" total wages and plaintiff's "Everywhere" total property. For its total wages, plaintiff uses a figure $1,439,055.93 greater than found in the Commission's application of the formula. Plaintiff uses as the value of its total property factor one exceeding the Commission's valuation by $1,248,454.42.

It, therefore, becomes evident, if plaintiff's figures are adopted for the wage and property factors, the "average percentage" of the three factors; that is, and the percentage of plaintiff's net income allocable to Oregon, is substantially less than it would be if the Commission's figures prevail. Following the figures used by plaintiff, that average would be 26.5839 per cent for 1956 and 33.0796 per cent for 1957. If, on the other hand, the Commission's figures are fairly compiled,

plaintiff's tax for these years would be assessed on 42.3313 per cent of its net income for 1956 and on 45.3703 per cent for 1957.

As previously indicated, plaintiff's tax return for 1956 follows the same method of calculation in the same factor categories as found in 1957 with, of course, some variants in amounts between the two years. But the reason which plaintiff assigns for the amounts it employs for the totals of the property factors and the wage factor in each tax year is identical for each annual return.

Plaintiff's figures in excess of those utilized by the Commission are extracted from the aggregate of its payments made to the contractors for the merchandise they furnish plaintiff on its order. The theory of plaintiff's case as expressed in its complaint is

> "* * * Plaintiff pays said third parties fees for such services, which fees represent a charge to plaintiff based upon wages paid by said third party, the use of the third party's equipment and facilities, and the overhead costs and profit of the third party, and to the extent of said wages and a reasonable rent for said use, said fees are actually wages and rent paid by plaintiff."

In support, plaintiff argues that its inclusion of wages paid by the contractors and value of property used by its third-party contractors overcomes what it calls the unfair and inequitable allocation made by the Commission of 'an excessive and unreasonable portion of plaintiff's net income."

These excessive wage and property amounts were

obtained by plaintiff by estimating what its contractors paid for contractors' labor in making garments for plaintiff. This is did by assuming that 70 per cent of the total cost of merchandise bought from the contractors was contractors' labor cost. In arriving at this estimate they adopted as a basic percentage an estimate of plaintiff's cost in Portland paid its employes for labor and its property charges allocable to production. Plaintiff, by using these estimates, further assumes that the percentages used prevail universally in the United States, notwithstanding that some of the contractors' plants are located in such diverse places as Maine, New Hampshire, Georgia and Oklahoma. It makes no adjustments whatever for any differential because of wage scales and cost of doing business in the areas in which its contractors operated.

We have already observed that the prices paid by plaintiff to each of its many contractors are the result of negotiations had in most instances with the contractors in the Portland office, where most of the contractors come each year or trade season to examine the models of the several garments and specifications and patterns therefor made by plaintiff. It is then a unit cost price is agreed upon. We do not understand that all contractors fashion all types of garments which plaintiff intends to market during the ensuing season nor that all make given type or style. This negotiated price includes the contractor's cost of manufacture, which includes the following costs of the contractor: labor, use of plant and overhead, plus a profit. The contractor neither rents his plant to plaintiff nor does

plaintiff pay the contractor's workmen, nor does plaintiff exercise any control over the contractor's employes. It follows that wages paid by the contractors and their estimated property costs are not activities which can properly be considered in determining where plaintiff's income is earned.

Without defining the legal relations subsisting between plaintiff and its several contractors, plaintiff attempts to give it a distinctive cast by referring to its contractor payments as "fees" and emphasizes the absence of formal "written" contracts and its willingness to later adjust the first negotiated price with some contractors on a basis which will insure to the contractor a fair profit. None of these features, in our opinion, overcomes the conclusion warranted by the record, that the true legal relationship of the contractors with White Stag Company is that of independent contractors.

Plaintiff is, of course, not precluded from otherwise obtaining a very positive fiscal advantage from the payments it makes to its several independent contractors. The total of the amounts it pays to each (and which necessarily includes the contractor's costs paid to labor, plant use, etc., plus its profit) would in the methods of usual accounting practices be deducted from its gross income in determining its net income, the item sought to be allocated, and mathematically diminish the amount of its net income pro tanto.

The provisions of Regulation 4.280(1)-(B) strongly

militate against the position urged by plaintiff, particularly when consideration is given to the definitions employed for the wage and property factors. That part of the regulation relating to the wage factor reads:

> "The wage factor is the percentage that the total wages, salaries and other compensation for personal services paid during the taxable year to *employes* in connection with the business carried on within this state bears to such payments to *employes* during the taxable year in connection with the business carried on both within and without this state.
>
> "Wages, salaries and other compensation must be included in the Oregon factor to the extent that services for which the compensation is paid were rendered in connection with the business carried on within the state. Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor." (Emphasis supplied.)

The "property factor" is therein defined:

> "The property factor shall be the percentage that the average value during the taxable year of the real and tangible personal *property used in the business* within this state bears to the average value during the taxable year of such *property used in the business both within* and without this state.
>
> "* * * * *
>
> "In determining the property factor, real property and tangible personal property rented or leased by the taxpayer, as well as real property and tangible personal *property owned by it*, used in the production of income, *must be included in the property factor*." (Emphasis supplied.)

As those factors are defined, they foreclose any right in plaintiff to add to the amounts paid to its

own employees that which the contractors paid to theirs or likewise add to its "everywhere property" factor amounts estimated or otherwise as representing the value of the contractors' property used in fulfilling the contractors' orders for merchandise manufactured for plaintiff. Even if we were to concede that plaintiff had "the use" of the properties of its respective contractors, it would not be enough to justify tacking such "use value" to its "everywhere property" factor, unless it be shown that plaintiff had a proprietary interest therein or control thereof. *Hines Lumber Co.* v. *State Tax Comm.*, 215 Or 453, 475, 336 P2d 75 (1959). But the record discloses no such claim of proprietary interest or control.

The evidence is clear to us that each independent contractor-manufacturer owned or leased, and controlled its respective plants and equipment, without any semblance of a leasing or subleasing to plaintiff; and that each contractor managed its own plant, hired, fired and paid its own employes and retained in full all profits resulting from its negotiated agreements made with the White Stag Company. Plaintiff makes no claim to the contrary.

To rebut the presumption that the Commission's formula is unfair or inequitable, the burden is upon the complaining taxpayer to make such a result manifest by clear and cogent evidence. *Dutton Lbr. Corp.* v. *Tax Com.*, 228 Or 525, 531, 365 P.2d 867 (1961), and cases there cited. This the plaintiff has failed to do. At most its evidence consists of demonstrating the man-

ner in which it computed and arrived at the several substantial estimated figures it employed in its returns for the years 1956 and 1957.

We also take note that plaintiff has cited us to no cases with a factual situation remotely comparable to the one projected by this appeal. Nor is our attention called to any treatises by tax authorities which lend any support to its thesis. Nor has our own diligence brought to light judicial precedent or arguments of tax experts which recognize or uphold the contentions of plaintiff.

Plaintiff asserts that Regulation 4.280(1)—(B), supra, when applied by the Commission as it has done, is unconstitutional, both under the Fourteenth Amendment of the Federal Constitution and Art I, § 32, of the Oregon Constitution, in that they impose substantially higher corporate excise taxes on plaintiff than are imposed by the laws of Oregon on other corporations earning the same net income in Oregon as plaintiff earned and its formula has allocated to Oregon income not earned by plaintiff in Oregon and thereby subjected to taxation that is not uniform on the same class of subjects. We find no merit in this representation. The constitutional questions raised have several times before had the attention of this court and federal courts and where they have been resolved against plaintiff's contention. *Dutton Lbr. Corp.* v. *Tax Com.*, supra (228 Or. at 539); *Hines Lumber Co.* v. *State Tax Comm.*, *supra* (215 Or. at 480); *Butler Bros.* v. *McColgan*, 315 U.S. 501, 86 L. ed. 991, 61 S. Ct. 701; *Under-*

wood Typewriter Co. v. Chamberlain, 254 U.S. 113, 65 L. ed. 165, 41 S. Ct. 45.

We do not find the formula applied by the Commission to plaintiff's returns arbitrary, unreasonable or in any sense unfair.

Plaintiff presents an alternative two-factor formula which it declares is more fair and equitable than the one used by the Commission. It is the same formula used by the state with the wage factor omitted. Having concluded that the Commission's three-factor formula was fair and equitable in the premises, we find no purpose in evaluating an alternative formula. Nor is it in our province to create new or what we conceive to be better formulas. That duty devolves solely upon the Commission. ORS 314.280.

The decree of the circuit court is affirmed.

5. Decree of the Supreme Court of Oregon August 14, 1962

BE IT REMEMBERED that at a regular term of the SUPREME COURT of the State of Oregon begun and held at the courtroom in the city of Salem on the first Monday of the 5th day of MARCH 1962, WHEREUPON on this TUESDAY, the 14th day of AUGUST 1962, the same being the 58th judicial day of said term, there were present:

WM. M. MCALLISTER, Chief Justice,

GEORGE ROSSMAN, Associate Justice,

HAROLD J. WARNER, Associate Justice,

WILLIAM C. PERRY, Associate Justice.
GORDON W. SLOAN, Associate Justice.
KENNETH J. O'CONNELL, Associate Justice.
ALFRED T. GOODWIN, Associate Justice, and
F. M. SERCOMBE, Clerk;

when the following proceedings were had:

WHITE STAG MANUFACTURING COMPANY, *Appellant*,	)	
v.	)	APPEAL FROM
DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, Members of and constituting the State Tax Commission of the State of Oregon, *Respondents*.	)	MULTNOMAH COUNTY

This cause on March 7, 1962, having been duly argued and submitted upon and concerning all questions arising upon the record and then reserved for further consideration, and the court having fully considered all said questions as well as suggestions of counsel in their argument and briefs finds there is not error as alleged.

IT THEREFORE IS CONSIDERED, ORDERED and DECREED that the decree of the court below rendered and entered in this cause be and the same is in all things affirmed.

IT IS FURTHER ORDERED that respondents have and recover of and from appellant their costs and disbursements in this court, taxed at $121.00.

IT IS FURTHER ORDERED that this cause be

remanded to the court below from which the appeal was taken with directions to enter a decree in accordance herewith.

6. Order Respecting Rehearing

BE IT REMEMBERED that at a regular term of the SUPREME COURT of the State of Oregon begun and held at the courtroom in the city of Salem on the first Monday of the 5th day of MARCH, WHEREUPON on this TUESDAY, the 18th day of SEPTEMBER 1962, the same being the 70th judicial day of said term, there were present:

WM. M. MCALLISTER, Chief Justice,
GEORGE ROSSMAN, Associate Justice,
HAROLD J. WARNER, Associate Justice,
WILLIAM C. PERRY, Associate Justice,
GORDON W. SLOAN, Associate Justice,
KENNETH J. O'CONNELL, Associate Justice,
ALFRED T. GOODWIN, Associate Justice, and
F. M. SERCOMBE, Clerk,

when the following proceedings were had:

WHITE STAG MANUFACTURING CO.	)	
Appellant,	)	APPEAL
v.	)	FROM
	)	MULTNOMAH
STATE TAX COMMISSION,	)	COUNTY
Respondent,	)	

The court having duly considered appellant's petition for rehearing, and being fully advised therein,

IT HEREBY IS ORDERED that such petition be and the same hereby is denied.

7. Oregon Statutes

ORS Oregon Revised Statutes.

314.280 Sec. 314.280 or ORS 314.280.

314.280 Allocation of income of corporation or nonresident individual from business within and without state. (1) If the gross income of a corporation or a nonresident individual is derived from business done both within and without the state, the determination of net income shall be based upon the business done within the state, and the commission shall have power to permit or require either the segregated method of reporting or the apportionment method of reporting, under rules and regulations adopted by the commission, so as fairly and accurately to reflect the net income of the business done within the state.

(2) The provisions of subsection (1) of this section dealing with the apportionment of income earned from sources both within and without the State of Oregon are designed to allocate to the State of Oregon on a fair and equitable basis a proportion of such income earned from sources both within and without the state. Any taxpayer may submit an alternative basis of apportionment with respect to his own income and explain that basis in full in his return. If approved by the commission that method will be accepted as the basis of allocation.. [1957 c.632 §4 (enacted in lieu of ORS 316.205 and 317.180)]

317.180 Allocating income earned both within and without state. (1) If the gross income of a corporation is derived from business done both within and without the state, the determination of net income shall be based upon the business done within the state. The commission shall have power to permit or require either the segregated method of reporting or the apportionment method of reporting, under rules and regulations adopted by the commission, so as fairly and accurately to reflect the net income of the business done within the state.

(2) The provisions of subsection (1) dealing with the apportionment of income earned from sources both within and without the State of Oregon are designed to allocate to the State of Oregon on a fair and equitable basis a proportion of the income earned from sources both within and without the state. Any taxpayer may submit an alternative basis of apportionment with respect to its own income and explain that basis in full in its return. If approved by the tax commission that method will be accepted as the basis of allocation.

8. Regulations of State Tax Commission of Oregon

Regulations 4.280(1)—(A), 4.280(1)—(B) and 4.280(1)—(C) replaced Regulations 7.180(1)—(A), 7.180(1)—(B) and 7.180(1)—(C), respectively. Except for the addition of one sentence in Reg. 4.280(1)—(B), the pertinent parts of Regulations 4.280(1)—(A), 4.280(1)—(B) and 4.280(1)—(C) are substantially the same as the regulations replaced by them. The pertinent

parts of Regulations 4.280(1)—(A), 4.280(1)—(B) and 4.280(1)—(C) are set forth below. The footnotes show the changes made by these regulations in the corresponding portions of the prior regulations.

Reg. 4.280(1)—(A). Allocation of Income Earned Both within and without Oregon. If a taxpayer carries on business or activity both within and without this state, the tax is measured by the portion of the net income properly attributable to[1] this state. The method to be used in determining the portion of the total income that is properly allocable to this state depends upon the circumstances in each case, and no rule of universal application can be stated. In most cases the circumstances are such that the income arising from the business done in Oregon must be determined by the apportionment method (Reg. 4.280(1)—(B)).[2] The segregated accounting method (Reg. 4.280(1)—(C))[3] is appropriate where the business or activity in and out of the state cannot be classed as unitary. * * *

* * * * *

Reg. 4.280(1)—(B). Apportionment Method. *Application.* If the business of the taxpayer is carried on both within and without this state, and the income properly attributable to Oregon may be fairly reflected only by treating the business within and without the state as a

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[1] At this place the additional words "the business carried on within" are in Reg. 7.180(1)—(A).

[2] In Reg. 7.180(1)—(A) at this place "Reg. 7.180(1)—(B)" appears instead of "Reg. 4.280(1)—(B)".

[3] In "Reg. 7.180(1)—(A)" at this place "Reg. 7.180(1)—(C)" appears instead of "Reg. 4.280(1)—(C)".

unitary business, the apportionment method must be used. The term "unitary business" means that the taxpayer to which it is applied is carrying on a business, the component parts of which are too closely connected and necessary to each other to justify division or separate consideration as independent units. Where Oregon activities are a part of a unitary business carried on within and without the state, the portion of the unitary income subject to tax in Oregon will be determined by the apportionment method. Where the activities carried on within the state are separate from the activities carried on outside of the state, the income subject to tax may be determined upon a separate accounting of the Oregon activities. Basically, if the operation of a business within Oregon is dependent on or contributes to the operation of the business outside the state, the entire operation is unitary in character, and the income from Oregon activities will be determined by the apportionment method. In all cases where the business is unitary, some type of an apportionment formula will generally be employed, not separate accounting. Even though the business is not of a unitary nature, it may be necessary to use the apportionment method if the net income of the Oregon business cannot accurately be determined from the taxpayer's records by use of the separate accounting method.

Apportionment Income. Income from property which is not a part of or connected with the unitary business is excluded from the income of a unitary business which is apportioned[4] by formula. Income from intangible

[4] At this place in Reg. 7.180(1)—(B) the word "allocated" is used instead of "apportioned".

personal property which is not a part of or connected with the unitary business shall be assigned to the domicile[5] of the taxpayer. The income from tangible and intangible personal property which is a part of or connected with the unitary business shall constitute apportionable income. * * *

* * * * * *

Apportionment Factors. After deducting the non-apportionable income, the remainder will ordinarily be apportioned to this state by giving equal weight to three factors, i.e., "property," "wagees," and "sales."

Property factor. The property factor shall be the percentage that the average value during the taxable year of the real and tangible personal property used in the business within this state bears to the average value during the taxable year of such property used in the business both within and without the state.

For use in the property factor, the value of which real and personal property should be included is the average of its use value for income production. To reflect such income production values, appraisement values for insurance purposes may be permitted or required, if in the opinion of the commission such appraised values are the best indication of the income production values. Real and tangible personal property includes land, buildings, machinery, stocks of goods, equipment, inventories, and other real and tangible personal property actually used in connection with the

[5] At this place in Reg. 7.580(1)—(C) the word "situs" is used instead of the word "domicile".

production of apportionable income. It is immaterial whether the property is owned or rented by the taxpayer. The test of its inclusion in the property factor is whether or not it is used or is capable of being used for the production of apportionable income. * * *

In determining the property factor, real property and tangible personal property rented or leased by the taxpayer, as well as real property and tangible personal property owned by it, used in the production of income, must be included in the property factor.

* * * * * *

The income production value of real property both within and without Oregon, which is rented or leased to the taxpayer, is determined by multiplying the net rents paid during the tax period by eight.

As to personal property rented or leased, the value ordinarily will be determined by applying to the net annual rental such multiplier for each type of property as the commission shall direct. The following multipliers have been established:

Machinery or equipment used in processing or manufacturing	5
Furniture and fixtures	5
Delivery or mobile equipment	4
Office machinery or equipment	3

The net rents are the gross rents paid by the taxpayer less the gross rents received by the taxpayer for subrentals.

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[6], [7] and [8] The matter dealt with in these three paragraphs is set forth in Reg. 7.180(1)—(B) as follows:

"In order to avoid unnecessary hardship on taxpayers

"Gross rents" as used in this regulation is the actual sum of money or other consideration payable directly or indirectly by the taxpayer or for its benefit for the use of the property * * *

* * * * *

In exceptional cases the use of the general method above outlined may result in inaccurate valuations. In such cases any other method which will properly reflect the value may be adopted by the State Tax Commission either on its own motion or on request of the taxpayer. Such other method of valuation may not be used by the taxpayer until approved by the commission. Any such request shall set forth full information with respect to the property together with the basis for the valuation sought by the taxpayer. Such other method once approved by the commission may be used by the taxpayer in its returns for subsequent years until the facts upon which such other method is based are materially changed.

* * * * *

Wage factor. The wage factor is the percentage that the total wages, salaries and other compensation for personal services paid during the taxable year to employes in connection with the business carried on within this state bears to such payments to employes during the taxable year in connection with the business carried on both within and without the state.

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and for ease of administration the income production value of real property and tangible personal property, both within and without Oregon, which is rented or leased to the taxpayer, is determined by multiplying the gross rents payable during the tax period by eight."

Wages, salaries and other compensation must be included in the Oregon factor to the extent that services for which the compensation is paid were rendered in connection with the business carried on within the state. Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor.[9]

* * * * *

Sales factor. * * *

The sales factor is the percentage that the sales or charges for services[10] within the state for the taxable year bear to the sales or charges for services[11] both within and without the state for the taxable year.

* * * * *

Reg. 4.280(1)—(C) Segregated or Separate Accounting Method. If the business is such that the use of the apportionment method is not required by Reg. 4.280(1)—(B)[12] then the income arising from the business conducted within this state must be determined by the separate accounting method. * * *

Reg. 7.180(1)—(A).

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[9] The following sentence:

"Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor."

in Reg. 4.280(1)—(B) is not in Reg. 7.180(1)—(B). The amendment adding this sentence was not promulgated by the State Tax Commission until after November 30, 1957.

[10] and [11] At these places Reg. 7.180(1)—(B) contains the additional word "performed".

[12] In Reg. 7.180(1)—(C) at this place "Reg. 7.180(1)—(B)" appears instead of "Reg. 4.280(1)—(B)".

Reg. 7.180(1)—(B).

Reg. 7.180(1)—(C). Regulations 7.180(1)—(A), 7.180(1)—(B), and 7.180(1)—(C) were replaced by Regulations 4.280(1)—(A), 4.280(1)—(B), and 4.280 (1)—(C). The portions of the regulations last mentioned that are set forth above are the same as the corresponding portions of regulations 7.780(1)—(A), 7.180 (1)—(B) and 7.180(1)—(C), except as indicated in the footnotes 1 through 12, pages A28 through A34.